Western Mass Estate Planning

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CREDIT SHELTER TRUSTS SUMMARY

FOR ESTATES SUBJECT TO MASSACHUSETTS ESTATE TAX ONLY

(last revised 1/15/23; not intended to be comprehensive of or specific to any particular situation)

Who Should Consider a Credit Shelter Trust?

If you are married and your combined taxable estate, after all expenses and debts, is more than $1,000,000 or is expected to grow beyond this amount in the future, Credit Shelter Trusts may assist you in reducing or even eliminating Massachusetts estate taxes upon the death of the second spouse.[1] Note that there is no federal estate tax assessed against estates of married couples whose assets are less than $25.84 million - $12.92 million per spouse (2023) - although the federal exemption is scheduled to "sunset" to $6.8 million/$13.6 million in 2026. A taxable estate includes all assets in which the decedent had an ownership interest at the time of his or her death, *including* life insurance, retirement accounts, and any assets owned with a non-spouse.

How are Massachusetts Estate Taxes Calculated?

Year	Threshold[2]	Tax Rate[3]
2008+	$ 1 m	approx. 6%

Example: An individual, including a surviving spouse, dies in 2023 with a taxable estate of $3m. Per the chart at left, the entire $3m is taxed at approximately 6%, for estimated Massachusetts estate taxes of $182,000.

Please note the following:

(A) When the first spouse dies, there is no estate tax paid, so these tax amounts are following the death of the second spouse only; and

(B) If one spouse is not a U.S. citizen, other special rules apply which would need to be discussed further.

How Do Credit Shelter Trusts Work to Save Taxes?

Credit Shelter Trusts allow married couples to, effectively, double the amount of assets they can leave tax-free to their heirs. Without effective pre-planning, the Massachusetts Department of Revenue bases estate taxes on a couple's total assets at the death of the *second* spouse, who benefits from only *one* threshold amount. Credit Shelter Trusts allow a couple to segregate $1

[1] Massachusetts has bi-partisan support to increase the $1 million *threshold* to a $2 million *exemption*, which will likely be introduced in the 2023-2024 legislative session. If it passes, married couples with Credit Shelter Trusts and estates exceeding $2 million will still save significant taxes which would otherwise be due at the second spouse's death.

[2] Unlike the federal system, Massachusetts currently imposes a threshold instead of a credit. This means that, if your taxable estate exceeds the threshold *to any extent*, the *entire* estate is taxed at the applicable tax rate. The actual tax rate depends upon the size of the taxable estate..

[3] The tax rates are graduated, from as low as .8% up to 16.0% - for many individuals, the blended result is approximately 6-7%

million of their assets upon the first spouse's death, so that those assets (plus any future appreciation) will not be counted for estate tax purposes on the second spouse's death. This is accomplished by creating two separate trusts: one for spouse #1 (of which that spouse is the Trustee and spouse #2 is the successor Trustee) and one for spouse #2 (of which that spouse is the Trustee and spouse #1 is the successor Trustee). Both trusts are completely amendable and revocable.

Upon creation, these trusts are funded with the couple's assets, in accordance with detailed instructions provided at the time of execution of the documents. Real estate, bank and investment accounts, and life insurance are divided as equally as possible and the trusts are used as owners or beneficiaries of each. Upon the death of the first spouse, up to $1 million in that spouse's assets is segregated and will not be included in the second spouse's taxable estate. If the first spouse's estate exceeds $1 million, a Massachusetts estate tax return must be filed, but no tax will be due. The surviving spouse continues to manage both trusts separately. When the surviving spouse dies, all of the assets in that spouse's trust, plus any which exceeded $1 million form the first spouse's trusts, are considered. If they total more than $1 million, a tax return must be filed and taxes paid, before the entire estate is distributed to the designated beneficiaries of the trusts.

<u>Example</u>: Suppose Fred and Norma have combined assets of $4,000,000. If Fred dies in 2023 with a standard Will leaving all of his assets outright to Norma, she will inherit them entirely tax-free as the surviving spouse. However, upon Norma's death in 2024, if she still holds assets with the same approximate value, her estate will incur Massachusetts estate taxes. For Massachusetts purposes, Norma's estate will exceed the $1 million threshold and the entire estate will be taxed at approximately 7% ($280,000). Distribution of the balance to Fred and Norma's heirs will occur only after this tax is paid in full. <u>If, however</u>, Fred and Norma had executed Credit Shelter Trusts during their lives, this tax could be significantly reduced. If the trusts are properly drafted and funded, Fred's trust would hold $1 million, which would then not be included in Norma's taxable estate at her death, leaving her taxable estate at $3 million. As a result, her estate would pay only approximately $182,000 in Massachusetts estate taxes, saving a total of roughly $98,000. If Norma is able to reduce the value of her estate to under $1 million before her death, we may be to eliminate the tax in its entirety.

Other Benefits of a Credit Shelter Trust

- They provide an alternative to gifting assets to others (generally, children) during life to reduce the taxable estate.
- All assets properly in the name of the trusts avoid the delay and expense of the probate court process at the death of each spouse.
- Designating a trust as beneficiary of an asset ensures that, if a beneficiary predeceases the owner, contingency provisions will be in place (as they are detailed in the trust)
- The provisions are confidential (whereas a Will becomes a matter of public record).
- The trust cannot easily be challenged by disgruntled beneficiaries.
- Because Credit Shelter Trusts are revocable and you serve as Trustees of your own trusts, all income and capital gains can be reported on your federal and Massachusetts income tax returns as you now report them. For your accountant's purposes, these are deemed "grantor trusts."

What Are Some of the Downsides of a Credit Shelter Trust?

- Some individuals find the process of re-titling assets into trust and completing change of beneficiary forms to be cumbersome. Once an asset is titled into trust, however, there is no further need to change titles until after the individual dies.
- Credit Shelter Trusts, and the necessary accompanying documentation, are more expensive for an attorney to prepare than standard Wills.